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ONE HUNDRED ELEVENTH CONGRESS

# Congress of the United States

## House of Representatives

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

2157 RAYBURN HOUSE OFFICE BUILDING

WASHINGTON, DC 20515-6143

MAJORITY (202) 225-5051  
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March 9, 2009

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### SUPPLEMENTAL MEMORANDUM

**To: Members of the Domestic Policy Subcommittee**

**From: Majority Staff**

**Re: Hearing on Oversight of the Troubled Assets Relief Program (TARP):  
Details of Questionable Spending by TARP Recipients, and Shortcomings of  
Treasury's administration of TARP.**

On Wednesday, March 11 at 10:00 a.m., in Room 2154 of the Rayburn House Office Building, the Domestic Policy Subcommittee will hold a hearing entitled, "Peeling Back the TARP: Exposing Treasury's Failure to Monitor the Ways Financial Institutions are Using Taxpayer Funds Provided under the Troubled Assets Relief Program." This is the second Troubled Assets Relief Program (TARP) oversight hearing held by the Domestic Policy Subcommittee.<sup>1</sup>

The hearing will assess the Department of Treasury's oversight of the largest of the five TARP programs, the Capital Purchase Program (CPP). The hearing will publicly identify a number of specific questionable transactions that TARP recipients have made since receiving TARP funds. The hearing will also explore the kind of information

<sup>1</sup> The subcommittee's first TARP oversight hearing examined whether TARP monies were being used for foreclosure prevention. See Domestic Policy Subcommittee, Oversight and Government Reform Committee, *Hearing, Is Treasury Using Bailout Funds To Increase Foreclosure Prevention, as Congress Intended?* 110<sup>th</sup> C. (Nov. 14, 2007) (online at: <http://domesticpolicy.oversight.house.gov/story.asp?ID=2276>). Section 109 of EESA requires Treasury to "maximize assistance to homeowners and... encourage the servicers of the underlying mortgages" to prevent home foreclosures "to the extent that the Secretary acquires mortgages, mortgage backed securities, and other assets secured by residential real estate..." Two days prior to the hearing, Secretary Paulson acknowledged for the first time that he did not intend to use the TARP monies for foreclosure prevention.

Treasury gathers from TARP recipients and its limitations, as well as deficiencies in the underlying TARP program's regulations and statute.

## **I. Establishment of TARP**

The Troubled Assets Relief Program (TARP) was established by Congress pursuant to the Emergency Economic Stabilization Act of 2008 (EESA or the Act).<sup>2</sup> The Act authorized a total of \$ 700 billion, to be obligated in two tranches, subject to a Congressional motion of disapproval.<sup>3</sup> Its purpose is twofold: 1) to restore liquidity and stability to the financial system, and 2) to ensure that funds are used in a manner that both maximizes overall returns to the taxpayer and provides public accountability.<sup>4</sup> To that end, Treasury has committed \$299.6 billion in TARP funds<sup>5</sup> to purchase preferred shares and warrants, extend loans and insure losses, at a large number of financial institutions.

TARP operates through five sub-programs: the Capital Purchase Program (CPP), Targeted Investment Program (TIP), Systematically Significant Failing Institutions Program (SSFI), the Asset Guarantee Program (AGP) and the Automotive Industry Financing Program. CPP is by far the largest of the five subprograms, having distributed \$194.18 billion to 317 banks.<sup>6</sup> CPP was intended for strong banks and provides them with capital injections in exchange for preferred stock shares and warrants. Participation in the program is voluntary and is initiated by application to the bank's regulator, and participants pay a strong interest rate on Treasury injections.

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<sup>2</sup> Emergency Economic Stabilization Act of 2008 (EESA), Pub. L. No. 110-343.

<sup>3</sup> EESA § 115(a) and 115(c).

<sup>4</sup> EESA § 2.

<sup>5</sup> Treasury: Office of Financial Stability, cited in SIGTARP, Initial Report to the Congress (Feb. 6, 2009) at 45 (fnt 4).

<sup>6</sup> *Id.*, at Table 3.2 and Table 3.6, respectively.

*Table 1. TARP allocations to the largest financial institutions*

Name of Financial Institution	Amount of TARP funds received (Billions)
Bank of America Corporation <sup>1</sup>	\$ 45
Citigroup, Inc. <sup>2</sup>	\$ 50
The Goldman Sachs Group Inc.	\$ 10
JP Morgan Chase	\$ 25
Morgan Stanley	\$ 10
Wells Fargo & Co.	\$ 25

<sup>1</sup> Bank of America Corporation received funds through two programs: \$25 billion through CPP and \$20 billion through TIP.  
<sup>2</sup> Citigroup Inc. received funds through three programs: \$25 Billion through CPP, \$20 billion through TIP, and \$5 billion through AGP.

## **II. What TARP Recipients are Doing Since Receiving Federal Funds: Specific Examples of Questionable Transactions**

In the past several months, a number of Congressional Committees have attempted to evaluate how TARP funds have been used. TARP recipients, for their part, have testified that they are using the funds as Congress intended.

For instance, Ken Lewis, CEO of Bank of America, stated at a recent hearing of the House Financial Services Committee,

“[A]ll of us at Bank of America understand the responsibilities that come with access to public funds. Taxpayers want to see how we are using this money to restart the economy and want us to manage our expenses carefully. These expectations are appropriate.”<sup>7</sup>

Similarly, Vikram Pandit, CEO of Citigroup, Inc., testified,

“We need to do a better job of acknowledging and embracing the new realities. Let me be clear with the committee: I get the new reality and I will make sure Citi gets it as well.”<sup>8</sup>

<sup>7</sup> Testimony of Ken Lewis, CEO, Bank of America, House Financial Services Committee *Hearing on TARP Accountability: Use of Federal Assistance by the First TARP Recipients* (Feb. 11, 2009).

<sup>8</sup> Testimony of Vikram Pandit, CEO, Citigroup Inc., House Financial Services Committee *Hearing on TARP Accountability: Use of Federal Assistance by the First TARP Recipients* (Feb. 11, 2009).

In contrast to those representations, Subcommittee Majority staff has identified a number of very large, questionable transactions from the thousands of individual transactions conducted by the largest recipients of TARP funds through the CPP after they received the TARP funds. These observations were made possible by means of testimony submitted for the Subcommittee hearing by Dow Jones & Co., a business information service company. The transactions are not illegal: EESA was mostly silent on prohibited transactions, and the funds provided through CPP were made without conditions. Treasury implementing regulations and term agreements with CPP recipients were similarly silent. However, Members of Congress might not consider them the kind of transactions they believed TARP would subsidize when they enacted EESA.

#### A. Questionable Transactions

- **\$ 8 Billion loan from Citigroup Inc. to Dubai public sector entities made on or about December 14, 2008.** Win Bischoff, then-Chairman of Citi, said about the transaction, "We continue to place the Gulf region among our globally most significant markets."<sup>9</sup> Citi received \$25 Billion of TARP funds on October 26, 2008.
- **\$ 1 Billion investment by J.P. Morgan Treasury Services in development of cash management and trade finance solutions in India made on or about November 11, 2008.**<sup>10</sup> J. P. Morgan Treasury Services is a wholly owned subsidiary of J. P. Morgan Chase & Co. J.P. Morgan Chase & Co. received \$25 Billion in TARP funds on October 26, 2008.
- **\$ 7 Billion investment by Bank of America in China Construction Bank Corporation, after November 17, 2008.** This purchase constitutes the exercise of an option acquired from China SAFE Investments Limited (Huijin).<sup>11</sup> Bank of America received \$25 Billion in TARP funds on October 26, 2008.

### III. Oversight of TARP

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<sup>9</sup> Citi, Press release, *Citi Arranges More than \$8 Billion for Dubai* (Dec. 14, 2008)(online at: <http://www.citigroup.com/citi/press/2008/081215a.htm>).

<sup>10</sup> J.P. Morgan Chase & Co., Press release, *J.P. Morgan Enhances Its Domestic Cash Management & Trade Services in India* (Nov. 11, 2008) (online at: <http://investor.shareholder.com/jpmorganchase/press/releasedetail.cfm?releaseid=347366&ReleaseType=Current>).

<sup>11</sup> Bank of America, Press release, *Bank of America to Exercise Remainder of China Construction Bank Option* (Nov. 17, 2008) (online at [http://newsroom.bankofamerica.com/index.php?s=press\\_releases&item=8295http://www.iht.com/articles/2008/11/18/business/views19.php](http://newsroom.bankofamerica.com/index.php?s=press_releases&item=8295http://www.iht.com/articles/2008/11/18/business/views19.php)).

Oversight of the TARP is performed within the Office of Financial Stability (OFS) at the Department of Treasury. OFS has been headed by Mr. Neel Kashkari, Interim Assistant Secretary for Financial Stabilization. Mr. Kashkari held the same position in the previous administration. He has been retained on an indeterminate basis by the new administration.

Section 116 of EESA requires Treasury to conduct oversight over the use TARP monies. Specifically, Treasury must “establish and maintain an effective system of internal control” of TARP monies in such a manner as to “provide reasonable assurance of the effectiveness and efficiency of operations, including the use of the resources of the TARP” and the “reliability of financial reporting.”<sup>12</sup> The Act mandates that this system of internal control be consistent with the standards prescribed under the Federal Managers Financial Integrity Act of 1982 (FMFIA).

Federal agency heads are required by law to prevent waste and loss of federal monies they administer. FMFIA requires executive agency heads to “establish internal accounting and administrative controls that reasonably ensure that... (B) all assets are safeguarded against waste, loss, unauthorized use, and misappropriation...”<sup>13</sup>

In 2004, the Office of Management and Budget promulgated regulatory guidelines for FMFIA, requiring heads of federal agencies to establish internal controls meeting a number of objectives. Those objectives are: 1) effectiveness and efficiency of operations, 2) reliability of financial reporting, and 3) compliance with applicable laws and regulations.<sup>14</sup> The guidelines go on to state, “safeguarding of assets is a subset of all of these objectives. Internal control should be designed to provide reasonable assurance regarding prevention of or prompt detection of unauthorized acquisition, use or disposition of assets.” Internal control activities refer to five categories of management responsibility: creating a control environment in terms of organizational structure and culture, employing risk assessment to identify internal and external risks, exercising control activities such as policies and procedures, disseminating information and communications to relevant personnel, and monitoring the effectiveness of internal control.<sup>15</sup>

The goals of TARP’s internal controls are governed by the purposes of EESA, and thus they are intended to give a “reasonable assurance” that the two purposes of EESA are being met: both the restoration of credit markets generally, and the maximization of

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<sup>12</sup> EESA § 116(c)(1).

<sup>13</sup> 31 U.S.C. § 3512(c).

<sup>14</sup> Revisions to OMB Circular A-123, Management’s Responsibility for Internal Control, Office of Management and Budget (Dec. 21, 2004) at 7.

<sup>15</sup> *Id.*

total shareholder return and accountability for the use of TARP funds to the taxpayer. It follows that Treasury has two primary TARP-related oversight obligations. First, Treasury is obligated to exert internal control over money coming in to and leaving from Treasury. Second, consistent with the terms of the CPP term agreements, Treasury is obligated to exert internal control on the use of TARP monies once they are within the financial institutions.

Currently, only the twenty largest recipients of CPP funds are required to file reports of any type with TARP overseers. The other 297 financial institutions do not.<sup>16</sup> These reports, known within Treasury as the Monthly Intermediation Snapshot, are delivered thirty days after the close of the reporting period, and are intended to enable Treasury to monitor trends in various lending and liquidity-creating activities.<sup>17</sup> These snapshots, to the extent that they provide insight into how recipients are using TARP funds, provide a general view – monthly aggregates – of large categories of credit activities.

In addition to the Snapshots, Treasury intends to use a quarterly analysis consisting of available data from the four bank regulatory agencies. What data will be collected and analyses conducted is currently the subject of discussions among the agencies and will consist in part of call report data, as well as other data gathered by bank examiners. Some will be incidental to routine bank examinations, while other data will be collected specifically for oversight of the TARP program.<sup>18</sup> At the current time, no firm decisions about the kinds of data to be collected have been made.

#### **A. Evaluation of TARP Oversight**

In January, GAO published its second report on TARP and found that Treasury's compliance with the formal requirements Circular A-123, the specific standards set forth by OMB for assessing and reporting on controls under FMFIA, "continues to evolve." GAO found that Treasury had "adopted a framework for organizing the development and implementation of its system of internal control for TARP activities."<sup>19</sup> Most of the several areas of internal control (control environment, risk assessment, control activities, information and communication, and monitoring) were in the planning stage, with policies in development and hiring underway.

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<sup>16</sup> Majority Staff phone interview with TARP staff (Feb. 12, 2009).

<sup>17</sup> Monthly Intermediation Snapshots are aggregated summaries of a number of lending activities. These activities include: consumer lending, commercial lending, and other intermediation activities such as purchase volume of mortgage backed and asset backed securities, secured lending, and underwriting.

<sup>18</sup> Staff phone interview, *supra* note 16.

<sup>19</sup> Government Accountability Office, *Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues* (Jan 2009) GAO-09-296 at 55.

Nevertheless, with nearly \$300 Billion in TARP funds already allocated, it is possible to assess the kind of information Treasury's internal controls is set up to gather and analyze. In the case of CPP, Treasury is attempting to assess the impact of TARP funds on the recipients' overall credit-making activities. By assessing aggregate monthly levels of certain banking activities, Treasury hopes to detect *correlations* between the presence of TARP funds and quantitative changes in the recipients' behavior in extending various kinds of credit.<sup>20</sup>

But there are significant shortcomings to Treasury's reliance on the Monthly Intermediation Snapshots. First, only the 20 largest TARP recipients report anything at all. Obviously, there can be little monitoring of the impact of TARP monies on the credit activities of the 297 TARP recipients which do not file Monthly Intermediation Snapshots. Second, the Snapshots do not provide details about any individual transaction, no matter how significant. Third, these Snapshots address the lending side of the recipients' business. They do not address any other investment or expenditure. Thus, the Snapshots, at best, serve the purpose of monitoring at the most general level some impact TARP funds may be having on certain lending activities, but not the use of TARP funds.<sup>21</sup>

Treasury has the right, pursuant to its term agreements with TARP recipients, to review company books.<sup>22</sup> In practice, Treasury has not deployed personnel to any of the

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<sup>20</sup> Staff phone interview, *supra* note 16.

<sup>21</sup> GAO has expressed some skepticism about whether Treasury will be able to isolate and measure the impact on TARP funds on credit and liquidity, both because TARP is one of several very large federal interventions in the credit markets, and because one cannot confidently state what would have happened in the absence of TARP. See discussion of measuring TARP's impact in *Troubled Asset Relief*, *supra* note 19 at 61-64.

<sup>22</sup> The Term Agreements give Treasury broad access to TARP recipient information. Specifically, Section 3.5 of the term agreements permit Treasury and its "agents, consultants, contractors and advisors (x) acting through the Appropriate Federal Banking Agency, to examine the corporate books and make copies thereof and to discuss the affairs, finances and accounts of the Company and the Company Subsidiaries with the principal officers of the Company, all upon reasonable notice and at such reasonable times and as often as the Investor may reasonably request and (y) to review any information material to the Investor's investment in the Company provided by the Company to its Appropriate Federal Banking Agency. Any investigation pursuant to this Section 3.5 shall be conducted during normal business hours and in such manner as not to interfere unreasonably with the conduct of the business of the Company, and nothing herein shall require the Company or any Company Subsidiary to disclose any information to the Investor to the extent (i) prohibited by applicable law or regulation, or (ii) that such disclosure would reasonably be expected to cause a violation of any agreement to which the Company or any Company subsidiary is a party or would cause a risk of a loss of privilege to the Company or any Company Subsidiary..."

largest CPP participants, other than a minimal presence at the two recipients which are also recipients of the TIP.<sup>23</sup> Nor has Treasury questioned any TARP recipient about its use of TARP funds.<sup>24</sup>

The causes of this shortcoming are several: First, at the inception of TARP, Treasury did not promulgate definitions of waste and abuse by regulation, nor did it define them in its contracts with TARP recipients, with limited exception. Second, the Emergency Economic Stabilization Act (EESA) which created TARP did not define waste or abuse either, with the limited exception of placing certain narrow restrictions on executive compensation. Third, in spite of broad investigative and audit authority, Treasury has chosen not to request detailed and comprehensive information from TARP recipients about their use of funds. As a result, Treasury has limited ability to detect or prevent waste and abuse at CPP recipient companies.

As a result, Treasury's oversight of TARP would not likely look for transactions such as those listed above. In the absence of rigorous regulatory oversight, media reports have been the only source of detailed information about how TARP recipients are spending their resources since receipt of TARP funds.<sup>25</sup> Some TARP recipients have shown sensitivity to how their spending patterns are perceived by the public through the media. As a result, it has also been reported that several recipients have voluntarily made changes to some of their corporate practices.<sup>26</sup> However, those voluntary changes are not being systematically monitored. They could be inconsistently applied by TARP recipient companies, and they could be revoked at any time. Thus, in the absence of governmental oversight, detection and prevention of waste and abuse of TARP monies is anecdotal rather than systematic.

### III. Conclusion

Under existing agreements between Treasury and TARP recipient financial institutions, Treasury has broad contractual authority to scour company books in search of, among other things, waste and abuse by TARP recipients. But in practice, Treasury is not doing so. In the absence of statutory or regulatory definitions of waste and abuse or explicit conditions for use of TARP funds – either promulgated in term agreements by Treasury under its broad authority, or prescribed by Congress in EESA – Treasury's

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<sup>23</sup> Staff phone interview, *supra* note 16.

<sup>24</sup> U.S. Treasury Department Response to Questions from the House Domestic Policy Subcommittee (Feb. 27, 2009).

<sup>25</sup> See, e.g. *Storm of bad publicity hovers over AIG*, O'Dwyer's PR Report, (Jan. 2009) Vol. 23, No. 1 at 3; *Goodbye, Goodies? Banks You Never Heard of Are Ladling Out Perks, Too*, The New York Times (Feb. 5, 2009) at B1.

<sup>26</sup> *Bailout Etiquette: Don't Get Caught Having a Good Time*, Los Angeles Times (Feb. 25, 2009) at C1.



oversight will not find them and cannot enforce them. In other words, Treasury is not now conducting oversight of TARP monies disbursed through the Capital Purchase Program to prevent their use for perks for company management, loans to foreign governmental authorities, investments in outsourcing jobs held by Americans, investments in foreign company operations overseas, and the repurchase of company common stock, or any other potential example of waste and abuse. In its current form, the Capital Purchase Program of TARP leaves recipient companies free to use federal funds as they would any other source of income, under the presumption that they use sound business judgment.<sup>27</sup>

### Witness List

#### **Panel One**

*Neel Kashkari*

*Acting Interim Assistant Secretary for Financial Stabilization, Department of Treasury*

#### **Panel Two**

*Professor Anthony B. Sanders*

*W.P Carey School of Business, Arizona State University*

*Stephen Horne*

*VP, Master Data Management and Integration Services, Dow Jones & Co.*

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<sup>27</sup> Under principles of corporate law, company management bears a fiduciary duty to shareholders to safeguard corporate assets and prevent waste and corporate mismanagement. Thus, “[w]aste of corporate assets is undoubtedly a clear case of egregious conduct” that does not enjoy the protection of the business judgment rule. Charles Hansen, *The ALI Corporate Governance Project: Of the Duty of Due Care and the Business Judgment Rule, a Commentary*, 41 BUS. LAW. 1237 n.55, (Aug. 1986) (citing *Kerbs v. California E. Airways, Inc.*, 90 A.2d 652 (Del. 1952)) [In Corporate law parlance, waste can be described as conduct without a corporate purpose. “Action that wastes corporate assets cannot have been taken in the honest belief that it was in the best interests of the corporation.” Hansen, *The Duty of Care, the Business Judgment Rule, and The American Law Institute Corporate Governance Project*, 48 BUS. LAW. 1355 (Aug. 1993). For example, waste would be found where corporate assets are sold for consideration that is excessively less than what a reasonable person would be willing to accept. Myron M. Sheinfeld and Judy Harris Pippitt, *Fiduciary Duties of Directors of a Corporation in the Vicinity of Insolvency and After Initiation of a Bankruptcy Case*. 60 BUS. LAW. 79 (Nov. 2004).

*Mark Bolgiano*  
*President and CEO, XBRL US, Inc.*

**Panel Three**

*Neil M. Barofsky*  
*Special Inspector General for the Troubled Assets Relief Program*

*Richard Hillman*  
*Managing Director, Financial Markets and Community Investment, Government Accountability Office*